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Melissa Newman
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

July 12, 1999

EX PARTE

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
445 12th Street, SW, TW-A325
Washington, D.C. 20554

RE: Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier for High Capacity Services in Phoenix, Arizona MSA, CC Docket No. 98-157

Petition of U S WEST Communications, Inc. for Forbearance from Regulation as Dominant Carrier for High Capacity Services in the Seattle, Washington MSA, CC Docket No. 99-1

Dear Ms. Salas:

On July 8 and 9,1999, John Kure, Jim Hannon and the undersigned, representing U S WEST, met with Kyle Dixon, Bill Bailey, Sarah Whitesell, Linda Kenney and Dorothy Attwood to discuss matters related to the above-captioned forbearance petitions for Phoenix and Seattle. The attached documents and maps summarize U S WEST's discussion and provide evidence of significant competition in high capacity services in these two metropolitan areas. Please include this letter and attachments in the record for the above-referenced proceeding.

In accordance with Section 1.1206(a)(1) of the Commission's rules, the original and one copy of this letter, with attachment, are being filed with your office. Acknowledgment and date of receipt of this transmittal is requested. A duplicate of this letter is included for this purpose.

Please contact me should you have any questions concerning this matter.

Sincerely,

Melissa Newman /EAM

Melissa Newman

Attachments
CC: Kyle Dixon
Bill Bailey
Linda Kenney
Dorthy Attwood
Sarah Whitesell
Tamara Preiss

U S WEST PETITION FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION IN THE PHOENIX, ARIZONA MSA
Executive Summary
July 1999

U S WEST's petition requests that the FCC exercise its authority under Section 10 of the Telecommunications Act of 1996 to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services (i.e., special access and dedicated transport for switched access at DS1 and higher transmission levels) in the Phoenix, Arizona MSA. The petition is narrowly tailored in terms of the services and geographic area covered, and the relief requested.

1. U S WEST Lacks The Ability To Exercise Market Power In The Phoenix Area Market For High Capacity Services

Following the approach the FCC previously has used to assess market power in the AT&T non-dominant proceeding and other proceedings, the renowned economists Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix area market for high capacity services.

First, as detailed in the Quality Strategies market analysis, U S WEST faces intense competition from both resellers and five established facilities-based competitors with substantial resources and extensive fiber networks. These established companies – which include the recently combined AT&T/TCG and MCI/MFS WorldCom companies – have access to resources equal to or greater than U S WEST's.

Second, U S WEST has a steadily declining market share. Indeed, competitive providers have captured more than 70 percent of the retail market for high capacity services. This is the most important market share statistic because the retail provider of high capacity services is the party that has the direct relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail provider has a significant marketing advantage over the facilities provider and, in the case of U S WEST's competitors, the ability to offer a full service package to the customer that includes interLATA voice and data services.

Further, expansion of the competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity services in the Phoenix market. During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the "provider" segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent. The competitive providers' market share of the "transport" segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone. Perhaps the most significant trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment. Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Phoenix area have captured a majority share of market growth over the past several years.

Third, there is high demand elasticity. The customers that tend to purchase high capacity facilities – medium to large businesses, governmental entities and other carriers – are highly sensitive to price and other service characteristics. The ability of U S WEST's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.

Fourth, there is high supply elasticity. Competitive providers have deployed more than 800 route miles of optical fiber in the Phoenix MSA. These extensive fiber backbone networks could handle all of U S WEST's end user and transport traffic at less than eight percent capacity. The only real constraint on competitive providers expanding service to U S WEST's customers is the need to build facilities to connect these sites to their existing fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand (DS1 equivalents) in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it is essentially located "on-network." Thus, competitive providers could absorb a majority of U S WEST's high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by POWER Engineers, Inc. demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. Specifically, competitive providers in Phoenix can serve all of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks (representing 86 percent of U S WEST's high capacity demand) if they invest $45 million, and all of existing U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks (representing approximately 95 percent of U S WEST's high capacity demand) if they invest approximately $127 million. Given that U S WEST's share of the Phoenix area market for high capacity services is worth approximately $50 million on an annual basis and the fact that the market has been growing steadily at about 13 percent annually, it is economically rational to assume that competitive fiber networks would be able to absorb most, if not all, of U S WEST's existing customers within a relatively short period of time.

Fifth, U S WEST does not enjoy an advantage in terms of its costs, structure, size and resources. To the contrary, the combined AT&T/TCG and MCI/MFS WorldCom companies enjoy a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services. The presence of competitive activity in the market while prices are dropping steadily is a strong indication that U S WEST does not have an insurmountable cost advantage in the market.

In light of U S WEST's lack of market power, Professors Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. In fact, Kahn and Tardiff conclude that continuing dominant carrier regulation of U S WEST's high capacity services in this highly competitive environment would be "anti-competitive and injurious to consumers."

2. U S WEST's Petition Satisfies The Section 10 Criteria For Forbearance

Section 10 requires the FCC to forbear from applying any regulation or provision of the Communications Act if the three statutory criteria are met. The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in a competitive telecommunications market. U S WEST's petition satisfies the Section 10 criteria for forbearance and is supported by substantial market evidence in accordance with the recent statements of Chairman Kennard.

First, dominant carrier regulation of U S WEST's high capacity services in the Phoenix area is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. U S WEST does not have the power to control prices in this market nor the ability to act in a discriminatory manner.

Second, because U S WEST cannot control prices or act in a discriminatory manner, dominant carrier regulation is not necessary to protect consumers.

Third, continuing to subject U S WEST's high capacity services in the Phoenix area to dominant carrier regulation deprives customers of the benefits of true competition by imposing unnecessary costs on U S WEST and hampering its ability to quickly and effectively respond to competitive initiatives. Further, asymmetrical regulation of U S WEST's high capacity services results in competitive distortions (e.g., "umbrella" pricing) that do not serve the public interest.

3. U S WEST Is Not Requesting That Its High Capacity Services Be Deregulated

U S WEST is not requesting that its high capacity services be deregulated - it is requesting only that the FCC exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the Phoenix area market for high capacity services. As a non-dominant provider, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support. The FCC also should free U S WEST's high capacity services from price cap and rate of return regulation, which are appropriate only for dominant carrier services. Moreover, the FCC should forbear from applying Section 69.3(e)(7) of its rules so that U S WEST can charge deaveraged rates within the Phoenix MSA. The effect of granting U S WEST's petition would be to place U S WEST on equal footing with all other competitors in the Phoenix area market for high capacity services.

U S WEST PETITIONS FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION OF ITS HIGH CAPACITY SERVICES IN THE PHOENIX AND SEATTLE MSAs

JULY 1999

SUMMARY

The Commission should consider all relevant evidence of competition in both the pricing flexibility and Section 10 forbearance contexts.

The Telecommunications Act of 1996 has a bias in favor of competition.

Regulatory safeguards should protect customers, not competitors.

Granting U S WEST's forbearance petition is compatible with a broader pricing flexibility mechanism and would help achieve the ultimate objective of pricing flexibility.

OVERVIEW OF U S WEST'S FORBEARANCE PETITIONS

Services. The market for "high capacity services" is comprised of special access and dedicated transport for switched access at DS1 and higher transmission levels.

Geographic Area. Metropolitan Statistical Areas ("MSAs") where U S WEST has accumulated compelling evidence that it lacks the ability to exercise market power for high capacity services.

Requested Relief. U S WEST is not seeking total deregulation, but rather non-dominant treatment. In other words, the same level of regulation as our competitors so that everyone is competing on a level playing field.

Public Interest. U S WEST's petitions satisfy the Section 10 criteria for forbearance, including the public interest standard.

- Asymmetrical regulation of U S WEST's high capacity services results in competitive distortions (*e.g.*, umbrella pricing).
- Customers are deprived of true competition because U S WEST cannot quickly and effectively respond to competitive initiatives.
- Dominant carrier regulation is not necessary to protect consumers.

Timeframe. U S WEST's Phoenix forbearance petition was filed on August 24, 1998 and its Seattle forbearance petition was filed on December 30, 1998.

U S WEST'S PETITIONS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE OF FULL-BLOWN COMPETITION

Following the approach consistently used by the Commission, the noted economists Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix and Seattle area markets for high capacity services.

First, U S WEST faces intense competition from both resellers and at least four established facilities-based competitors in each market. These established competitors include the recently combined AT&T/TCG and MCI/MFS/WorldCom companies.

Second, U S WEST has a steadily declining market share.

- Competitive providers have captured more than 70% of the retail market for high capacity services.
- From 4Q 1994 to 2Q 1998, competitive providers' market share of the "provider" segment (*i.e.*, high capacity services ultimately purchased by end users) increased from less than 6% to more than 30%.
- This trend is likely to continue, as competitive providers have captured a majority share of new demand for high capacity services over the past several years.

Proximity to a competitive provider's fiber backbone also demonstrates the presence of competition.

- Competitive providers have strategically constructed their fiber networks within 100 feet of customer locations which account for a majority of U S WEST's high capacity services in the Phoenix and Seattle MSAs.
- It would be easy for competitive providers to absorb significant customers and revenue from U S WEST.

U S WEST'S FORBEARANCE PETITIONS ARE COMPATIBLE WITH AN INDUSTRY-WIDE PRICING FLEXIBILITY PLAN

U S WEST fully supports the Commission's efforts to adopt an industry-wide pricing flexibility plan, provided the forbearance alternative afforded by Section 10 is not compromised in the process.

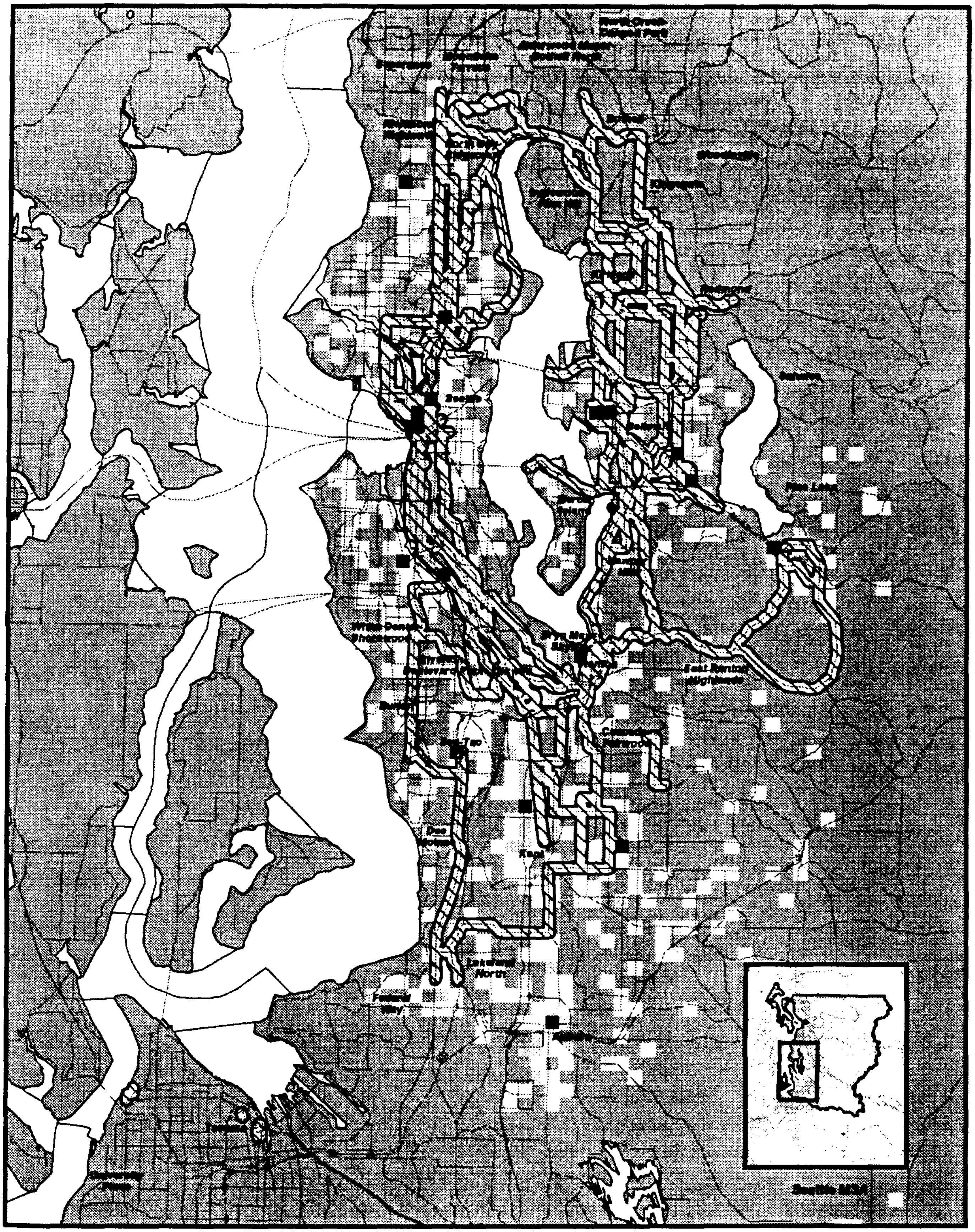
Section 10 requires the Commission to forbear from dominant carrier regulation where the statutory criteria have been satisfied. U S WEST's forbearance petitions are supported by extensive evidence and are limited to high capacity services within specific metropolitan areas.

The Commission can and should establish a more broadly available pricing flexibility mechanism for all access services.

In fashioning a broader pricing flexibility plan, the Commission should focus on simplicity and avoid the temptation to design a complex set of rules that would be burdensome to administer

Moreover, an industry-wide pricing flexibility plan is not a substitute for giving full and careful consideration to U S WEST's forbearance petitions based on their own merits.

Granting U S WEST's forbearance petitions would help achieve the ultimate objective of pricing flexibility – a fully competitive market where non-dominant regulation of all carriers creates a level playing field and unleashes the full benefit of competition for consumers.



Competitive Provider Coverage of U S WEST DS1 Equivalent Services

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2 0 2 4 Miles

Legend

Buffer area within 1000 ft. of CAP Fiber

Highways

DS1 Equivalent
1 - 10
11 - 28
29 - 200
201 - 1000
> 1000

Notes:
1. Sources : CAP Fiber from Power Engineering 1998 Survey. Customer data from U S WEST customer billing records.

12/29/98